Office of the Auditor General of Canada
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CANADIAN WHEAT BOARD

SPECIAL AUDIT REPORT

PRESENTED
to the
BOARD of DIRECTORS

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CANADIAN WHEAT BOARD
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EXECUTIVE SUMMARY

This special audit examined the financial accounting and reporting systems of the Canadian Wheat Board (the CWB or the Corporation), as well as the key management systems and practices that we considered essential to achieving its expected corporate results. The scope of the audit included governance, strategic planning, performance measurement and reporting, marketing, grain transportation, financial operations, communications and corporate policy, information technology, and price pooling. The special audit did not examine or comment on the mandate and role of the CWB as a single-desk seller of wheat and barley grown in western Canada.

The Office of the Auditor General of Canada is independent of the CWB; there were no restrictions placed on the scope of our audit and we obtained all of the information and explanations we considered necessary to complete it.

The CWB has recently undergone significant changes in the way it carries out its business, as a result of global market changes, increased market competition, the decreasing level of grain prices throughout the 1990s, and escalating pressure on its monopoly status from inside and outside Canada. Some of these changes were also a result of amendments to the *Canadian Wheat Board Act*. These amendments, aimed at improving the transparency, accountability and flexibility of the CWB's operations, included the following:

- the establishment of a Board of Directors, the majority of whom are farmers elected to the Board;
- the hiring of a President/Chief Executive Officer; and
- the introduction of flexible pricing options for farmers.

This special audit was part of a call for increased transparency and accountability by the CWB. However, the timing of our audit meant that we reviewed the organization during a period of significant change and transition. Thus, it was not surprising that the audit found some significant deficiencies as well as areas where improvements can be made, in the key management systems and practices we examined.

Significant deficiencies in governance, strategic planning processes, performance measurement and reporting, and information technology.

- **Governance**. The CWB has made progress in implementing the new governance structures required by changes to the CWB Act. However, the Board of Directors has spent a significant amount of time addressing several key operational issues and, in our view, has become too involved in day-to-day management issues. As a result, the Board has not focussed enough on its broader mandate of oversight and strategic direction. To make this shift, we believe that the Board and senior management need to further clarify their respective roles and responsibilities.

- **Strategic Planning.** We noted that corporate plans and budgets developed by the CWB to date have been based on a one-year time frame. The Corporation is now developing a five-year strategic plan to identify its strategic direction and long-term goals and objectives. In completing this plan, the CWB needs to address other weaknesses our audit noted, by ensuring that the initiatives to be undertaken are clearly linked to the strategic goals and that the detailed plans of the operating divisions are properly aligned with the strategic plan.

- **Performance measurement and reporting.** With an increased focus on strategic planning comes the need to identify and report against performance measures and targets to determine the extent to which the Corporation has achieved identified outcomes. At all levels of the organization we observed a number of weaknesses in performance measurement and reporting. Performance data exist and management is using them to make decisions that support daily operations. However, the Corporation needs to develop a comprehensive and balanced set of performance measures and improve its reporting against them, with an emphasis on desired results and outcomes. The goal must be to ensure that the CWB measures and reports its performance properly so it can be more accountable to farmers and stakeholders.

- **Information technology.** Our audit of the management of information technology found a number of deficiencies in governance, planning, systems development, and performance measurement. These included a lack of stable and effective leadership; the absence of a corporate-wide strategy and long-term plan for information systems; inconsistent review and monitoring of projects; the lack of a single life-cycle methodology for systems development; and inconsistent use or no use of business cases, including analysis of options, to support technology investment decisions. Management completed a comprehensive review during our audit and has developed an action plan to address these weaknesses. The plan includes changes in executive leadership and a greater emphasis on project management. These actions should help to move the management of this function to a level appropriate for a mature organization that depends heavily on information technology.

Areas where improvements can be made to further strengthen management systems and practices

We found that the CWB has accumulated considerable expertise and experience in grain marketing and transportation. The management and financial accounting and reporting systems and practices that we examined were complex but well-developed; however, we noted some areas where further improvements could be made.

- **Marketing farmers' grain.** In our meetings with industry participants and stakeholders, we observed that the CWB has a solid reputation as a strong and capable marketer of high-quality grains. Its key strengths include good intelligence and market information, well-developed annual sales strategies and plans, competent and tough negotiators, and good relations with customers over many years. However, the CWB's marketing function needs to complete a long-term marketing plan and ensure that its annual sales strategies and plans are integrated with its long-term marketing strategies. The documentation and evaluation of the sales negotiation process could also be improved. In addition, the market development program and performance of Accredited Exporters could be evaluated more formally and the Corporation could benefit more fully from the knowledge, efficiency, and expertise of Accredited Exporters by working more closely with them as strategic partners.

- **Transportation and country operations.** For more than two years, the Board of Directors and management have paid significant attention to the new roles played in the grain transportation system and tendering process; this has included extensive negotiations with the industry. We found that the CWB has established appropriate systems and practices to manage the orderly delivery, handling, and transportation of grain in order to meet its overall objective of optimizing returns to farmers. However, it should inform farmers and other stakeholders of those key performance indicators and targets it has established for the handling and transportation of grain and the loading of vessels.

- **Managing financial operations.** The CWB has established proper financial accounting and reporting systems and practices to record financial transactions and report, by pool account, the final results of operations for the crop year. We found that the Corporation is properly reporting the final results of

its operations by pool account in the financial statements, and that the CWB is appropriately managing its financial risks from an operational viewpoint. However, we did note a number of revenues and costs that are netted or grouped in the presentation of the final results of operations by pool account. To improve accountability and transparency, the CWB should provide details in its financial statements of all of the significant revenues and costs associated with its operation of the pool accounts. It should also consider whether it would be more equitable to share equally among all farmers the total net interest earnings on credit receivables. Last, management needs to improve the level and detail of its reporting on financial risk management activities and results to the Board of Directors.

- **Communications and corporate policy.** The CWB has increased its communications with farmers as a result of its enhanced emphasis on transparency and accountability. It has also developed and effectively communicated its positions on policy areas such as biotechnology and trade disputes. However, the communications and corporate policy functions lack operational plans with clear goals and strategies to guide activities and measure and monitor performance.

- **Price pooling and payments to farmers.** The pooling of farmers' returns is one of the main responsibilities of the CWB under its Act. We found that the Corporation is calculating the total net pooled returns to farmers properly in accordance with its Act and its price-pooling policy. The CWB would be more accountable and transparent if it explained to farmers how the price pooling policy affects the calculation of their total net pooled returns and reported more detailed information on returns for each pool account.

Conclusion

Based on our special audit, in our opinion, except for the significant deficiencies we have noted in governance, strategic planning, performance measurement and reporting, and the management of information technology, there is reasonable assurance that

- the key systems and practices we examined operated in accordance with relevant legislation and corporate policies, and
- those key systems and practices were maintained to provide reasonable assurance that the resources of the corporation were managed economically and efficiently and its operations were carried out effectively.

Further, in our opinion, the financial accounting and reporting systems of the Corporation were managed economically and efficiently. For the pool account years ending in 2000, the financial accounting and reporting systems and practices provided reasonable assurance that

- the financial transactions of the Corporation by pool account and crop year were accurately recorded in the proper accounts,
- the allocations among pool accounts and other estimates required to determine the annual results of operations were reasonable, and
- all revenues from the sale of grain, less operating costs, were distributed to producers in accordance with the requirements of the *Canadian Wheat Board Act* and the CWB's price-pooling policies.

INTRODUCTION

The Canadian Wheat Board (the CWB or the Corporation) is charged with the orderly marketing in interprovincial and export trade of grain grown in western Canada. As a single-desk seller, it attempts to optimize what farmers earn from the wheat and barley they grow and market through the CWB; as such, it significantly impacts the lives of most grain farmers in western Canada. Recent changes in the global economy and markets and in the domestic industry structure and delivery systems have presented significant challenges to the way the CWB does business. The Corporation has had to deal with these challenges while adapting to a new governance structure. During our audit, we recognized that the CWB was in a state of transition due to these changes and challenges.

Mandate

Bill C-4, *An Act to amend the Canadian Wheat Board*, received royal assent on June 11, 1998. Section 8.1 of the new *Canadian Wheat Board Act* was included as a result of an amendment by the Senate. This section states:

> Within two years after the day this section comes into force, the Auditor General of Canada may commence an audit of the accounts and financial transactions of the Corporation for such fiscal years as the Auditor General considers appropriate and a report of the audit shall be made to the Corporation and the Minister.

On March 2, 2000, the Board of Directors of the CWB passed a resolution agreeing to an expanded scope for this audit. In addition to an audit of the CWB's financial accounting and reporting systems, as provided for in the Act, the resolution approved a more broadly scoped examination to assess the efficiency, effectiveness, and economy of selected management systems and practices of the CWB.

Objectives

In accordance with section 8.1 of the *Canadian Wheat Board Act* and with the March 2, 2000 resolution of the Board of the Corporation, we carried out a special audit of selected key financial and management control and information systems and management practices of the CWB. The purpose of our audit was to determine whether the Corporation has reasonable assurance that

- the key systems and practices we examined operated in accordance with relevant legislation and corporate policies, and
- those key systems and practices were maintained to provide reasonable assurance that the Corporation's resources were managed economically and efficiently and its operations were carried out effectively.

Our responsibility is to express an opinion on whether there was reasonable assurance that the key systems and practices we examined met those objectives and to report our findings and conclusions on areas where we believe improvements are needed.

In particular, our audit plan provided for an examination of the financial accounting and reporting systems and practices used by the CWB to process, record, and report financial transactions in its accounts and to report the results of the pool account operations. We examined these systems and practices to determine whether, for the pool years ending in 2000, they provided reasonable assurance that

- the financial transactions of the Corporation by pool account and crop year were accurately recorded in the proper accounts,
- the allocations among pool accounts and other estimates required in determining the annual results of operations were reasonable, and
- all revenues from the sale of grain, less operating costs, were distributed to producers in accordance with the requirements of the *Canadian Wheat Board Act* and the Board's pooling policies.

Scope and criteria

A plan for the examination, based on our survey of the Corporation's systems and practices, was submitted to the Audit and Finance Committee on October 25, 2000. The plan included the examination criteria to be applied in the special audit. These criteria define the standards against which systems and practices were assessed, in terms of the results that systems and practices are intended to achieve and not the way they should be designed. The examination criteria are listed in Appendix A.

The plan also identified the key systems and practices that we considered essential to providing the Corporation with reasonable assurance that its resources are managed economically and efficiently and its operations carried out effectively. We selected these systems and practices for detailed examination based on our analysis of their significance and associated risks to the achievement of the Corporation's expected results.

Our examination was made in accordance with the plan and with the standards for assurance engagements recommended by the Canadian Institute of Chartered Accountants. Accordingly, it included such tests and other procedures as we considered necessary in the circumstances.

This special audit did not examine or comment on the mandate and role of the CWB, in particular its role as a monopoly, single-desk seller of wheat and barley, including

- the objects or purposes of the Corporation or restrictions on the businesses or activities it may carry out,
- the objectives of the Corporation, and
- any policy decisions of the government that relate to the CWB.

Period under examination

The period under examination is normally defined as the period that extends from the beginning of the survey to the completion of the field-work—in this case, from April 2000 to December 2001. However, the examination of the systems and practices relating to pool financial accounting and reporting and the preparation and reporting of the financial statements related specifically to the pool account years ending in 2000. To gain a better understanding of the systems and practices selected for in-depth examination, we also examined certain matters that preceded the starting date of the special audit. In all other respects, however, the audit focussed on the current operations of the CWB.

Examination approach

The special audit team's approach was to focus on results rather than on processes, or the structure and functioning of systems and practices. We examined whether the systems and practices were adequate to ensure that the Corporation achieved its expected corporate results economically and efficiently. We examined in depth only the systems and practices (areas) that are critical to the achievement of the key results desired.

Independence

The Office of the Auditor General of Canada is independent of the CWB; there were no restrictions placed on the scope of our audit and we obtained all of the information and explanations we considered necessary in the circumstances to complete the audit.

BACKGROUND AND CONTEXT

The CWB was established in 1935 as a voluntary marketing agency to provide producers with a government-guaranteed initial price and to stabilize the grain futures market. By the 1940s, the increasing demand for grain created by the war and the failure of the futures market led the government to grant monopoly powers to the CWB. Since then, the CWB has grown to be the world's single largest exporter of wheat and barley and one of Canada's largest export companies. Its monopoly status as a single-desk seller of western Canadian wheat and barley has been one of the pillars of its success. However, its monopoly status has also been at the root of many challenges and criticisms, both domestic and international.

The CWB has made significant changes in the way it carries out its business, in response to global market changes, increased competition for markets, the decreasing level of grain prices throughout the 1990s, and escalating pressures from inside and outside Canada. Some of these changes also reflect the amendments to the *Canadian Wheat Board Act*. Aimed at improving the transparency, accountability, and flexibility of the CWB's operations, the amendments included

- the establishment of a Board of Directors, the majority of whom are farmers elected to the Board,
- the hiring of a President/Chief Executive Officer, and
- the introduction of flexible pricing options for farmers.

This special audit was part of a call for more transparency and accountability by the CWB. However, the audit's timing meant that we reviewed the organization in a period of significant change and, despite having operated for over 65 years, in many ways the CWB is a new and different organization. It is an organization in transition, with a Board of Directors and management who must address new needs and challenges. The following table presents in general terms the transitions the CWB is making and their impact on its operations

FROM (OLD)	TO (NEW)	NEED/IMPACT
Exempt Crown corporation; closely associated with the federal government; with reputation for secrecy	Shared-governance organization; no longer an agent of the Crown; greater separation from the government	Portray a new identity where farmers are in control; become more transparent and accountable to farmers and industry
Structure where Commissioners were both the Board and the executive management; elitist, secretive, closed shop image; perceived "oldboy" structure; lack of separation of governing body from operations	Board of Directors, with 10 elected by farmers and 5 appointed; CEO in charge; separation of the Board from management; more direct accountability to farmers	Implement a corporate governance structure; orient and train new Directors; agree on roles and information needs between Board and management; agree on how to govern with elected Directors
Annual, crop-year focus; predominantly short-term view of operations	More-strategic focus; long-term view of operations	Implement a strategic planning process; develop and implement long-term plans and initiatives
Internationally, many State Trading Enterprises (STEs) for exports and imports	Fewer STEs; bilateral and multilateral pressures on single-desk sellers for clarification of disciplines	Co-ordinated policy and approach to dealing with trade challenges
Marketplace and customers dominated by dealings at the country level; fewer, less discriminating customers	Dealings more at the individual customer level; fewer at the country level; many more customers; customers more demanding	Increased need for customer relationship management; increased demands on marketing staff; increased emphasis on information and market development
Major disputes with railways; blurred lines of accountability with grain companies and railways; subsidized grain transportation moving to freight rate caps	Impact of Estey and Kroeger reports; lengthy negotiations with railways and grain industry; move to a commercially oriented contracting system	Improved cooperation with railways and grain companies; administer and ensure fair tendering process and cost effective transportation with clearer accountability
Industry dominated by co-ops; many grain elevators and transportation points	Industry rationalization; fewer and larger grain companies; more high-throughput elevators and fewer, smaller country elevators	Major shift in grain transportation and logistics systems

In this context of transition, we present the following findings and observations of our audit work in each of the project areas.

FINDINGS AND OBSERVATIONS

Governance

The CWB's Board of Directors is responsible for the overall governance and strategic direction of the Corporation. This includes

- setting clear goals, objectives and targets,
- monitoring the performance of the Corporation, the CEO, and the Board of Directors itself, and
- ensuring that internal controls and reporting procedures are adequate and effective.

Ten elected and five appointed directors, including a Chief Executive Officer (CEO) appointed by the government, began governing the CWB in January 1999. The new "shared governance" structure is intended to make the CWB more transparent and accountable to farmers, its principal stakeholders.

We found that the Board has a diverse mix of skills and experience. In its first three years, the Board has spent considerable time developing its new governance structures. At the same time, it has had to deal with a number of key operational issues such as improving communications with farmers, implementing changes to the grain handling system, and looking for ways to benchmark the value of the monopoly. During this period, the Board has also

- obtained external guidance on governance,
- developed a comprehensive governance manual to guide its governance activities,
- established an appropriate standing committee structure and set the terms of reference for the committees,
- developed and implemented a process for evaluating the performance of the CEO and a self-assessment process for the Board, and
- begun to implement a comprehensive planning, performance measurement, and reporting system for the Corporation.

We noted that the CWB Board has generally longer and more frequent meetings (10 to 12 times a year) than comparable boards. The Conference Board of Canada recently concluded that public and private sector boards that meet 10 to 12 times a year (instead of 5 to 6 times) tend to become too deeply involved in operations. In our opinion, this is true of the CWB's Board. As a result, it has not focussed enough on its broader mandate of oversight and strategic direction. A recent study by the Corporation also identified the need for the Board and senior management to further clarify their respective roles and responsibilities.

The Directors of the Board have told us that the main reasons for their significant time commitment and involvement in operations in the first three years were a steep learning curve and their strong desire to make a difference to farmers (who elected 10 of them). Directors believe that a lot has been accomplished, though they acknowledge that this has sometimes required of them more hands-on involvement in the operations of the CWB. Nevertheless, we believe the Board needs to clearly differentiate between its strong need and desire for operational information and involvement and its role of setting strategic direction and holding management accountable for the Corporation's performance.

Strategic planning

One of the major roles of the Board of Directors is to set the strategic direction of the Corporation by clearly articulating the Corporation's mandate and identifying its long-term goals and objectives. Once it has set the strategic direction, the Board should work closely with management to develop the strategies for achieving the Corporation's long-term goals and objectives. Strategic planning is the process of pulling all of this information together into a comprehensive plan.

We reviewed the CWB's corporate planning process and noted the following weaknesses:

- The corporate plans and budgets developed by the CWB to date have been based on a one-year (crop year) time frame.
- The CWB needs to improve the linkage between the strategic goals (desired outcomes) identified in the plans and the initiatives or actions the Corporation will undertake to achieve them.
- The Corporation has not defined clearly for planning and budgeting purposes what constitutes an initiative (should the budget include all initiatives with a significant impact or just those that require additional funding?).
- There are inconsistencies between the corporate plans and budgets in the recording of initiatives and their financial impact.
- The CWB lacks clear and measurable targets to assess its ongoing performance against the plans.

During the audit, management developed a new framework and timetable that the Board approved to guide and align the Corporation's future planning, budgeting, and reporting. In addition, the Board and management carried out the following:

- an environmental scan of the major issues that will present challenges and opportunities for the CWB over the next five years;
- a discussion of what the Corporation's core values, areas of strategic focus, and goals should be;
- an analysis and evaluation of strategic alternatives; and
- a discussion of a draft five-year strategic plan.

The Corporation expects to have the completed five-year strategic plan approved by the Board early in 2002. In finalizing this plan, the CWB needs to ensure that:

- initiatives are clearly linked to strategic goals and the strategic plan identifies all significant initiatives;
- the strategic plan and budget are properly aligned;
- the detailed plans of each operating division are properly integrated with the strategic plan; and
- clear and measurable targets are established to measure, monitor, and report on the future success of the Corporation's initiatives and operations.

Performance measurement and reporting

The Board of Directors also needs to ensure that it has a reliable means using meaningful indicators and measures to assess the Corporation's ongoing performance, while monitoring external conditions that could enhance or jeopardize its success. Our audit reviewed the Corporation's performance measurement and reporting practices and noted the following weaknesses:

- As reported in our findings under strategic planning, the Corporation lacks clear and measurable targets, both financial and operational, to assess its performance.
- Reporting on the Corporation's performance, both by management to the Board of Directors and in the Corporation's annual report, is focused mainly on the results of activities (outputs) as opposed to the achievement of results (outcomes).
- There is limited reporting by management to the Board against performance measures identified in the corporate planning documents.
- The delay in issuing the Corporation's 1999-2000 annual report diminished its effectiveness as a report on performance.

However, we did note that

- a lot of good performance data exist and are used by management to make decisions for efficient and effective functioning of the Corporation's daily operations,
- the Board of Directors closely monitors the Corporation's general and administrative expenses each quarter and follows up on any significant variances from budgeted amounts, and
- the production of the 2000-01 annual report is well ahead of last year's.

Based on our audit, we concluded that overall the Corporation's performance measurement and reporting practices were not developed well enough to assist the Board in overseeing and evaluating management's performance, or to fully report on the Corporation's performance to farmers and other interested stakeholders.

It should be noted that the Board has developed a process and will identify a set of performance benchmarks to assist it in demonstrating to western Canadian farmers the relative value of the CWB's single-desk selling monopoly. However, these benchmarks are not intended to serve as a comprehensive set of corporate performance measures that the Board could use to oversee and evaluate management's performance.

In summary, the Board and management need to do more work to develop an appropriate performance measurement and reporting framework for the CWB that would include the following:

- a comprehensive and balanced set of performance measures and targets that address all key aspects of the Corporation's mandate, objectives, and operations;
- clear linkage of the strategic goals, initiatives, and performance measures and targets in the Corporation's strategic plan to those reported in its annual report; and
- improved reporting to the Board against performance measures, with an emphasis on desired results and outcomes.

Improvements in the way it measures and reports its performance will also help the Corporation communicate the results of its activities more effectively to farmers and other stakeholders.

Our audit also found deficiencies in the measuring, monitoring, and reporting of performance in most of the operational areas we examined, although we noted that good performance data exist and are used by management. The deficiencies were in marketing farmers' grain, transportation and country operations, communications and corporate policy, and information systems and technology. They are discussed with our observations on those activities.

Marketing farmers' grain

The CWB operates in a competitive business environment. It now markets grain in over 70 countries to customers who have widely varying requirements for quality and price. Customers range from those who demand and are willing to pay for the highest quality and service to those who view CWB products as no different from generic wheat and barley available from other exporters. In 1999-2000, the CWB completed about 5,000 contracts and achieved sales revenues of more than $4.3 billion.

In the past, the CWB faced a simpler marketing environment. A large proportion of its sales went to a small number of foreign government agencies, which bought large volumes. These agencies had more flexibility to accept and pay for a wide range of grades and protein levels. This situation changed over the last decade with the increasing liberalization of markets and the gradual disappearance of some key central buyers. Import markets became more sophisticated and specific about the quality they wanted. These dramatic changes in the global market continue today and heighten the need for the Corporation to use best marketing practices.

Market intelligence and information

One of the CWB's key strengths is the gathering of market information and intelligence to identify future market requirements. Our audit found that the CWB has been able to reasonably predict future prices and supply, and its predictions have become more accurate over the last three years. Also, in publishing its *Grain Trade Forecast* the CWB prepares a thorough analysis and projection of market requirements by country and by major grain, and it shares some of this information with the industry and farmers.

Long-term market planning

At the time of our audit, the CWB's good market information and forecasts had not yet been incorporated in a completed long-term marketing plan. The plan in draft form responds to forecasts of market demand and outlines a strategy for supplying specific grades and volumes to particular countries. Once approved, these longer-term strategies should be updated frequently and integrated fully in making crop-year decisions, including those on market development. This will ensure that short-term logistic and sales pressures are consistent with the CWB's longer-term objectives for its customer mix.

Annual planning

The detailed sales plans for each crop year are very thorough, providing detailed information by pool account and market. They are updated monthly and form the cornerstone of monitoring the CWB's ongoing sales progress and activities. However, as we have indicated, it will be important for the Corporation to ensure that the monthly sales plans are integrated and consistent with its longer-term plans and strategies.

We also found that the crop year sales plans do not include important indicators of performance relating to the results or outcomes of specific strategies—for example, premiums earned to date by market; sales to targeted customers, and other indicators of country portfolio management.

Sales negotiations

In our meetings with industry participants and stakeholders, we observed that the CWB has a solid reputation as a strong and capable marketer of high-quality grains. CWB marketers are viewed as tough negotiators on price. Each sale follows a process of approvals, including limits for each marketer, and each sale is evaluated. However, marketers need to formalize their documentation of the negotiation background to prepare for the next sale to the same customer and to assist in evaluating the process. How consistent this information is with the longer-term marketing strategies should be evaluated.

The CWB monitors price performance against standards, and an independent group verifies that contracts adhere to policies. However, the CWB could benefit from a more comprehensive monitoring of all stages of a sale's life cycle, beginning with the negotiation and ending with an evaluation of the customer's satisfaction after the end user has received the grain. A record of this monitoring could not only include a summary of the sales negotiation and a more formalized assessment of contract specifications but also indicate whether the right grain of the right grade was delivered on time and the related storage and financing costs.

Use of Accredited Exporters

Accredited Exporters are private grain companies that work with the CWB to make sales in specific markets. The CWB does evaluate their performance, but in a subjective way. The Corporation should review and revise the roles and responsibilities defined in the annual agreement with all Accredited Exporters in order to increase trust and improve working relationships.

It should also consider moving away from a broad use of Accredited Exporters to a selection of strategic partners that could

- complement the structure of the CWB and enhance its capability and expertise,
- be market-specific and/or region-specific, and
- be based on past performance, capacity in specific markets, as well as other criteria such as approaches to market development and cultural fit with the CWB.

Market development

The CWB's Market Development program has aided product development through projects like the development of new varieties and the evaluation of their relative processing characteristics. In these development activities the CWB relies on partnerships with the Canadian International Grains Institute, the Canadian Grain Commission, and other institutions.

This program and the evolving role of the Accredited Exporters needs to be evaluated in terms of factors such as service, price, customer contact, timeliness of shipments, consistency of quality, and technical support. This would assist in establishing a strong and formalized customer relationship management program.

Performance monitoring and reporting

Deficiencies in performance measurement were identified in the marketing areas of sales plans, sales negotiations, performance of Accredited Exporters, and market development. The CWB must continue to work toward a more integrated and comprehensive measurement of its effectiveness in allocating sales to different markets and negotiating prices. Improved measurement of the performance of key marketing functions will enable managers to know if they are fully delivering and demonstrating to farmers the advantages of single-desk selling.

In summary, the CWB's marketing systems and practices have been in place for many years and are well established and directed toward obtaining premiums from the marketplace. However, as we have noted, the Corporation needs to improve its systems and practices in some areas to keep pace with the changes in the industry.

Transportation and Country Operations

The grain handling and transportation system in Canada has a history of heavy regulation by the federal government. The design and functioning of the system has also been the subject of intense study and debate by industry participants over the years. In June 2000, after extensive consultations, the federal government passed new legislation to enhance the competitiveness and accountability of the grain transportation system. Under the new legislation, the CWB retained its historical role of contracting for and allocating rail cars. The CWB also agreed to begin tendering a portion of its grain shipments for export sales.

Meanwhile, there has been significant consolidation and rationalization of the industry. This has resulted in grain company mergers and the closing of many smaller country elevators, which have been replaced by high-capacity and high-throughput elevators.

Grain deliveries

The CWB issues grain delivery calls as needed to meet its sales commitments. The percentage of grain for delivery is the same for all farmers in order to provide them with an equitable opportunity to deliver a portion of their grain. The CWB manages the overall distribution and timing of the delivery calls across Western Canada to ensure that farmers have equitable opportunities to deliver their grain during the crop year.

We reviewed the delivery calls process and found that the calls were being made as needed to meet sales commitments. We noted that in some cases, the Corporation has called forward into the country elevator system more grain than was needed to meet short-term sales commitments. The CWB says this is done for a number of reasons, including to avoid potential delivery difficulties, to respond to nearby sales opportunities, and to make grain available to meet tendering requirements, as well as, in some cases, to provide farmers with timely access to cash flow.

The CWB incurs financing and storage costs on CWB grain stored in the country elevator system until the grain is transported to a final point of sale. It sets targets for and monitors the average number of days and the inventory turnover ratio of CWB grain stored in the country elevator system during the crop year.

We also noted that although farmers can apply for a $50,000 interest-free cash advance under the federal government's cash advance program, only 30 percent of farmers do so. More farmers using the cash advance program for their cash flow needs could reduce the total costs the CWB incurs to finance and store its country grain inventories.

Grain transportation

The CWB tracks and estimates on an ongoing basis the total supply of grain available for sale in western Canada. It uses this information to plan its sales and determine the most cost-efficient transportation method and use of port facilities to meet sales requirements during the crop year. The CWB also enters into grain handling and transportation agreements and contracts with the grain, lake vessel and railway companies. The agreements and contracts specify the responsibilities of each party and the rates to be paid for the handling and transportation of grain.

We reviewed the CWB's new process for allocating rail cars to the grain companies to transport non-tendered grain; we found that the car awards process functions properly. However, we noted that the four-week grain shipment projections that the CWB provides to the grain companies are not always based on the most current information available.

We also reviewed the CWB's new process for tendering a portion of its grain shipments for export sales. We found that

- the Corporation awards the tenders to the grain companies based on the lowest actual price,
- the majority of the bids it accepts from the grain companies are lower than the posted freight tariff rates, resulting in a net savings for farmers on handling costs, and
- the CWB monitors the total tonnage of awarded tenders to ensure that it is meeting the minimum requirements specified in the new grain handling and transportation agreement.

We noted that the CWB monitors the total number of rail cars offered to it by the railways and the average number of days the railways spend transporting grain. This monitoring is to ensure that the railways are providing the appropriate volume of rail cars on a timely basis and are meeting their service commitments to the CWB.

Terminal operations

The CWB monitors the accuracy of grain deliveries at ports to ensure that the grain companies are delivering the correct quantities and grades of grains. It has established a process to reward or penalize the grain companies based on the weekly accuracy level of their deliveries compared with the weekly average for all the grain companies. However, we noted that it has established no minimum level of accuracy, nor has it analyzed whether the financial rewards and penalties are sufficient. We believe the CWB should examine these factors with a view to encouraging more accurate deliveries.

The CWB pays the costs of storing grain in the terminal elevator system until the grain is loaded onto a customer's vessel. It sets targets for and monitors the average number of days and the inventory turnover ratio of CWB grain stored in the terminal elevator system during the crop year.

In co-operation with the Canadian Grain Commission, the CWB makes blending decisions to load the customers' vessels. The purpose of blending is to expedite the loading of customers' vessels and make the most efficient use of the CWB's grain inventories to meet or exceed the minimum grade and protein levels required in the sales contracts. Blending results in a net cost to the CWB when the blended grades

and protein levels applied exceed the minimum grade and protein levels required under the sales contract. We reviewed the application decisions made by the CWB and found that the CWB closely monitors and attempts to minimize any over-application of grades and protein levels in meeting its sales commitments. The total estimated costs resulting from the over-application of grades and protein levels was less than 2 per cent of the total export sales for the 1999-2000 crop year.

The CWB incurs demurrage charges if it is unable to load the customer vessels on time. Conversely, it earns despatch if it can to load vessels faster than called for in the sales contracts. The CWB sets targets for and monitors the average number of days it takes to load customer vessels at port.

Performance measurement and reporting

The logistics involved in handling and transporting large volumes of CWB grains for export sales are complex. Strong working relationships and agreements between industry partners are essential to ensure the best performance of the grain handling and transportation system. Overall, we found that the CWB has established proper systems and practices to manage effectively the orderly delivery, handling, and transportation of grain.

Nevertheless, we believe that the CWB should inform farmers and other stakeholders of those key performance indicators and targets it has established for the handling and transportation of grain and the loading of vessels. It should explain how it established the indicators and targets, whether it has met them, and if it has not met them, why. The indicators and targets could include the average number of storage days and the turnover rates for CWB grains stored in the country and terminal elevator systems, the level of accuracy it expects grain companies to meet in their deliveries, the total estimated costs resulting from the over-application of grades and protein levels, and the expected number of days to load vessels. We believe that this information would help make the CWB's operations and results more transparent and accountable to farmers and other interested stakeholders.

Managing financial operations

Financial accounting and reporting

Our audit reviewed the CWB's financial accounting and reporting systems and practices and found that they provide timely, accurate, and relevant financial information for operating and financial reporting purposes. We also found that for the crop year ending in 2000, the financial transactions by pool account were recorded accurately in the proper accounts, and the allocations among pool accounts and other estimates required to determine the final results of operations by pool account were reasonable.

We noted that the CWB's grain sales under the federal government's agricultural export credit programs are guaranteed by the government. As a result, the CWB bears little or no credit risk with respect to the repayment of the principal and interest balances on these credit receivables. The total net interest earnings on the credit receivables are recorded in the pool accounts to which the original credit sales related, in accordance with the requirements of the *CWB Act*. For the crop year ending in 2000, the total net interest earnings on the credit receivables were $55.4 million. The allocations to the pool accounts on a per tonne basis and as a percentage of the total amount available for distribution to farmers for the crop year are shown below.

Pool Account	$/Tonne	%
Wheat	2.59	1.44
Amber durum wheat	1.75	0.86
Feed barley	8.31	6.16
Designated barley	0.16	0.09

As the table shows, this recording method results in considerable variations both in the amounts recorded in each of the pool accounts and the percentage impact on the total net pooled returns to farmers. In our opinion, the CWB should consider whether it would be more equitable if the total net interest earnings on credit receivables were shared equally among all farmers, based on the total tonnage of grain delivered by farmers for all the pool accounts during the crop year.

In addition, we noted that the CWB nets or groups certain revenues and costs in presenting the final results of operations by pool account. Examples include

- the vessel loading and ocean freight costs; gains and losses on commodity and foreign exchange contracts; and sales commissions, which are netted against sales revenues, and
- the net interest earnings on credit receivables, which are grouped together with net interest earnings on the pool account operations.

In our opinion, to improve transparency and accountability to farmers and other stakeholders, the CWB should consider reporting in its financial statements all of the significant revenues and costs associated with its operation of the pool accounts.

Borrowings

The CWB borrows money to finance its credit sales, make payments for grain deliveries and other operating costs, pay its administrative and general expenses, and provide advances to farmers. The federal government guarantees all borrowings by the CWB, and the Corporation can borrow money at rates comparable with those available to the federal government.

The CWB makes a daily forecast of its cash flow requirements, and bases its daily borrowing decisions on the availability and cost of funds in the capital markets. The Corporation has established borrowing programs in various capital markets around the world to ensure that it has access to enough funds to meet its daily cash requirements. Operating lines of credit provide access to additional funds if necessary. The CWB also borrows money over and above its daily cash requirements and uses it for short-term investments. This practice ensures that it has enough funds available to meet its future obligations, and it takes advantage of favorable borrowing conditions that exist in the markets from time to time.

The CWB regularly monitors, analyzes, and reports on all of its borrowing activities to ensure that they comply with borrowing approvals and restrictions. It regularly evaluates the performance of each borrowing program against appropriate market benchmarks to ensure that it is borrowing cost-effectively.

Management of financial risk

The CWB's financial risk management policies and limits comply with the Minister of Finance's guidelines for financial risk management and have been approved by the Board. The major sources of financial risk for the CWB are related to adverse changes in commodity prices and foreign exchange

rates. The CWB uses futures contracts to manage the commodity price risk on its basis sales and fixed price contracts and the foreign exchange risk on its export sales of grain.

It should be noted that the CWB is currently restructuring its wheat pool pricing strategies. It will use the restructured strategies to enhance its ability to price the wheat pool and manage the commodity price and foreign exchange risks associated with its physical sales of wheat.

The CWB regularly monitors, analyzes, and reports on all of its financial risk management activities to ensure that they comply with limits approved by the Minister of Finance and with its own financial risk management policies and limits. However, we believe that management needs to improve the level and detail of its reporting to the Board on treasury risk management activities and results. The CWB is currently working on this.

Communications and corporate policy

Communications

Communications have become a priority for the Corporation, and the main target audience is the western Canadian farmer. Farmers are one of the four strategic focus areas in the 2001-02 CWB Corporate Plan/Business Plan. This focus area emphasizes that the CWB should be accountable and transparent and represent farmers' grain marketing interests. The Corporation recently created the Farmer Relations department, which works closely with the Corporate Communications department but reports separately to the President/CEO.

We noted that the CWB has developed effective tools to communicate with its external stakeholders. Corporate Communications is staffed by professionals who shadow and work with all CWB operations as a team, providing input on issues that impact on communications

The CWB surveys farmers by various means, including an annual survey that identifies farmers' views and perceptions and services they would like the CWB to offer. The survey results assist the CWB in developing its strategic direction, goals, and policies.

Corporate policy

The scope of the Corporate Policy Group includes policy work on grain-related continental and international trade, industry/secondary processing, and price analysis. Corporate Policy has also been proactive in developing an analytical understanding of the CWB's operations and providing policy direction aimed at maximizing the CWB's efficiency and market effectiveness. For example, together with staff in the Legal and Sales departments, Corporate Policy began preparing for the recent trade action two years before the official launch by the United States. This was the result of Corporate Policy's monitoring efforts and its co-ordination with other areas in the CWB and with federal government departments. Close co-ordination with all interested stakeholders has been instrumental in the successful defense of the CWB against repeated U.S. investigations and trade actions.

Corporate Policy has provided key support to the Market Development department's efforts to monitor and respond to biotechnology issues and proposals. It works closely with key decision-makers on these issues and participates in six external committees that directly address biotechnology. The Corporation

has surveyed farmers and customers about these issues and has developed, posted publicly, and communicated the CWB's position on biotechnology.

The Corporate Policy group has attracted competent individuals to shadow and respond to complex issues that face the CWB. Internal committees, with representation from relevant operational divisions, have been formed around high-priority areas, and the CWB networks and partners with individuals and organizations that can provide outside expertise. However, we noted a lack of documented guidelines on how to prepare position statements and shadow trade issues. Such guidelines would help to avoid duplication, promote more efficient processes, and minimize the possible loss of corporate memory.

Although strategies have been developed for key issues such as biotechnology and the World Trade Organization, both Corporate Policy and Corporate Communications lack documented annual and long-term operational plans with clear goals and strategies to guide activities and to measure and monitor performance.

Performance measurement and reporting

For both Corporate Communications and Corporate Policy, we note that

- there has been limited reporting against the success measures identified in the CWB Business Plan; and
- reports to senior management and the Board focus primarily on activities.

The CWB's 1999-2000 annual report has the same weaknesses. It lacks performance measures and is inconsistent in reporting on outcomes; reporting to stakeholders on some key aspects of the CWB's performance is therefore limited. We also had difficulty relating the strategic themes described in the report to those approved by the Board, which makes it more difficult to analyze results against plans. Also, although the CWB's external auditors signed off on the 1999-2000 financial statements in December 2000, the annual report was not available to the public and farmers until June 2001. However, the final results of operations were reported to farmers in the January/February 2001 edition of *Grain Matters*. Since the relevance of information depends largely on its timeliness, the annual report would be more useful to its readers if it were published closer to the time period it covers. We did note improved co-ordination and communication among divisions in preparing the upcoming 2000-01 annual report.

In summary, the CWB does support its mandate through regular communication and interaction with key stakeholders and by responding to trade challenges. However, both Corporate Communications and Corporate Policy should develop annual and long-term operational plans and a comprehensive structure for measuring, monitoring, and reporting on performance.

Information systems and technology

The CWB relies heavily on its information technology (IT) systems to carry out its operations in a timely and effective way. It spends between $15 million and $20 million a year and uses about 25 percent of its human resources to develop, maintain, and operate information technology systems. The CWB's current IT systems are complex and numerous. Most of them are older systems that have been functioning properly for many years and were upgraded at a significant cost to prepare for the changeover to the year 2000.

Our audit found many significant weaknesses in the CWB's IT management systems and practices, in the areas of governance, strategic planning, systems development, and performance measurement and reporting. We based our assessment on current best practices of IT management in organizations of a similar size and complexity. We concluded that the Corporation's IT management systems and practices have not reached the level of maturity that we would expect to find in an organization with many years of IT experience and a critical dependence on technology for the continuing success of its operations.

The weaknesses we noted include the following:

- lack of stable and effective leadership of the Business and Information Systems group over the past several years;
- lack of a corporate-wide strategy and long-term plan for information systems to determine how they will support the Corporation's business direction and operations;
- a priority list of new systems projects to be undertaken in the current crop year that did not consider the availability of IT resources;
- inconsistent compliance with project review procedures and ad hoc monitoring rather than formal project review sessions;
- lack of a single life-cycle methodology for systems development to assist in developing new IT projects; and
- inconsistent use or no use of business cases, including analysis of options, to support technology investment decisions.

During the audit, however, the CWB completed a comprehensive review of its IT management systems and practices and prepared a detailed action plan to address these weaknesses. Most important, it has taken the following actions to address the weaknesses and improve its IT management systems and practices:

- Established a senior management committee to oversee the IT function. This committee will prioritize all new IT projects based on their strategic importance and the availability of resources.
- Hired a Vice President of Information Technology under the newly appointed Executive Vice-President, Corporate Affairs. The Vice President will manage the IT function and develop a long-term IT strategic plan to rationalize the current IT systems and infrastructure and support the future strategic direction and operations of the CWB.
- Established a Project Management Office (PMO) to monitor and report on all ongoing IT projects. The PMO is to provide timely and accurate information on the status of projects against appropriate measures. This should allow decision-makers to better manage the costs and schedules of IT projects and help the organization better realize their benefits.

The CWB recognizes that it needs the continued strong support and commitment of the Board of Directors and senior management to ensure the future success of its IT function and its ability to maximize the return on its IT investments.

Price pooling and payments to farmers

Appendix B of this report summarizes the CWB's price pooling policy. It describes the purpose of price pooling and outlines how the CWB calculates the total net pooled returns to farmers in accordance with the requirements of the *CWB Act*.

Our audit found that the CWB calculates the total net pooled returns to farmers in accordance with the requirements of the *CWB Act* and the CWB's price pooling policy. We also found that in accordance with the requirements of the *CWB Act*, all revenues from the sale of grain, less operating costs, were properly distributed to farmers for the crop year ending in 2000.

However, to help make the CWB's operations more transparent and accountable to farmers, the CWB should consider reporting the following in its annual report or elsewhere:

- its price pooling policy, including how the total net pooled returns to farmers are calculated; and
- the total net pooled returns by class, grade, and protein level for each of the pool accounts, on a crop-year-over-crop year basis.

CONCLUSION

Overall, except for the significant deficiencies noted below, we found that the Corporation does have appropriate management systems and practices directed at meeting its expected corporate results and at optimizing returns to grain farmers. The significant deficiencies relate to the need to

- clarify the respective roles and responsibilities of the Board of Directors and management;
- develop clear, long-term strategies and plans and ensure that the detailed plans of operating divisions are aligned with the strategic plan,
- ensure that the CWB measures and reports on its performance against appropriate indicators and outcomes, and
- improve the management of information technology.

The CWB also needs to improve in a number of other areas, as outlined in preceding sections of this report.

We believe that acting to address these deficiencies and areas for improvement will help the CWB's Board of Directors and management better demonstrate their accountability to farmers and provide them with better information for decision-making.

Based on our special audit, in our opinion, except for the significant deficiencies we have noted in governance, strategic planning, performance measurement and reporting, and the management of information technology, there is reasonable assurance that

- the key systems and practices we examined operated in accordance with relevant legislation and corporate policies, and
- those systems and practices were maintained to provide reasonable assurance that the resources of the corporation were managed economically and efficiently and its operations were carried out effectively.

Further, in our opinion, the financial accounting and reporting systems of the Corporation were managed economically and efficiently. For the pool account years ending in 2000, the financial accounting and reporting systems and practices provided reasonable assurance that

- the financial transactions of the Corporation by pool account and crop year were accurately recorded in the proper accounts,
- the allocations among pool accounts and other estimates required to determine the annual results of operations were reasonable, and
- all revenues from the sale of grain, less operating costs, were distributed to producers in accordance with the requirements of the *Canadian Wheat Board Act* and the CWB's price-pooling policies.

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada
Ottawa, Canada
December 21, 2001

APPENDIX A

EXAMINATION CRITERIA

Marketing of Farmers' Grain: *The CWB should optimize total sales returns to farmers through the development and implementation of appropriate marketing strategies and plans, working arrangements and support activities.*

Transportation and Country Operations: *The delivery and transportation of grain should be done in an orderly, cost-efficient and effective manner and should comply with legislative requirements.*

Managing Financial Operations: *The CWB's records and books of account should be properly maintained and its operating requirements should be appropriately financed, while minimizing exposure to financial risks.*

Communications and Corporate Policy: *The CWB should be accountable and transparent to farmers and support its mandate through regular communication, interaction with key stakeholders and response to trade challenges.*

Price Pooling and Payments to Farmers: *Transactions in the pool accounts should be properly recorded and reported and the total net returns to farmers should be calculated in accordance with the CWB Act and the CWB's price-pooling policy.*

We have also developed examination criteria for those key systems and practices needed to ensure there is proper management, direction and support in place in the Corporation, as follows:

- Governance and strategic planning: *The Board of Directors should work closely with stakeholders and management to set the strategic direction for the CWB and the strategies for achieving the CWB's expected corporate results, and oversee and evaluate management and CWB's performance in order to ensure that the CWB is fulfilling its mandate.*

- Performance measurement and reporting: *The performance of the CWB's operations and its management and staff should be regularly evaluated and reported on, based on clear goals and objectives and performance measures, to assist in decision-making, promote continuous learning, and enhance accountability to stakeholders.*

- Information technology systems: *The CWB's information systems and operations should be properly planned, organized and managed on a cost-effective basis, to support the direction and operations of the CWB.*

APPENDIX B

PRICE POOLING AND RETURNS TO FARMERS: A PRIMER

What is the purpose of price pooling?

Price pooling shares the market risks among all western Canadian farmers by giving each farmer his or her fair share of the highs and lows of the marketplace. It also removes the risk for farmers that prices will drop before they are able to harvest or deliver their crop, because it guarantees that farmers will receive the same total payment for the same grade of grain, regardless of when the grain is actually delivered during the crop year.

Price pooling also has an important impact on the CWB's ability to market farmers' grain. Price pooling allows the CWB to focus on taking advantage of different customers' willingness and ability to pay for different levels of quality for grain and optimizing the efficiency and effectiveness of the Canadian grain handling and transportation system as a whole. The goal is to optimize the total net returns for each of the pool accounts for the crop year.

How does price pooling work, in a nutshell?

Price pooling is sometimes mistakenly viewed as an averaging of the actual prices received for a specific grade of grain during a crop year. However, if the CWB pooled returns by grade, this could result in a situation where a lower grade might receive a higher return than a higher grade. This could happen if the lower grade was sold during a period of the crop year when the market price structure was higher than during the period when the higher grade was sold. Clearly, this is not the intent of price pooling.

The CWB's price pooling policy states that farmers will receive a total net pooled return that reflects the relative market values that the market has placed on the different grades of grain sold by the CWB during the crop year. The CWB does this by keeping track of the price spreads that existed in the market for the different grades sold by the CWB during the crop year. Therefore, the total net pooled returns received by farmers are not a simple average of the actual prices received for each grade sold by the CWB during the crop year.

What factors are taken into account in price pooling?

While the average price received by each grade of grain is affected by a number of factors, the CWB's price pooling policy also states that the total net pooled returns received by farmers shall not be unduly influenced by the:

- timing and direction of sales, which are largely determined by buyers, and to a lesser extent, by the existing constraints in the Canadian grain handling and transportation system;
- discretionary application of different grades to different markets, in order to optimize the total sales revenues for each of the pool accounts for the crop year;
- adverse impacts of competitors' export subsidies, which can vary over the course of the crop year, by type of grain and between countries; or
- impact of any increases in operating costs caused by such events as weather related transportation problems, a shortage of rail cars, or demurrage charges due to delays in loading vessels at port.

Price pooling attempts to remove the impact of the above factors, where appropriate, by ensuring that the:

- total net pooled returns received by farmers reflect the price spreads that existed in the market for the different grades sold by the CWB during the crop year; and
- total operating costs are spread across all classes and grades within a pool account, and thus are shared equally among all farmers.

What factors are not pooled?

The CWB does not pool the quality of grain or the costs to transport the farmers' grain to the nearest point of export. Farmers receive an initial payment based on the quality of their grain, and they pay for the costs of transporting their grain to the nearest point of export.

How does the CWB determine the relative market value of each grade of grain?

The CWB tracks the price spreads that existed in the market for the different grades sold during the crop year. These price spreads are used to determine the relative value contributed by each grade to the pool accounts.

Price spreads are calculated by analyzing the estimated selling prices for similar grains sold by competitors. The estimated selling prices are, for the most part, based on the U.S. futures prices, which are readily available and very transparent. The estimated selling prices also reflect the different quality (market) premiums and discounts that are available at each of the U.S. port positions, but do not reflect the additional premiums that the CWB is able to extract from some of its customers. Instead, the additional premiums which are attributed to the CWB' status as a single-desk seller are shared equally among all farmers within a pool account.

However, it isn't always possible to determine the price spreads based solely on an analysis of the competitors' selling prices, particularly where grades sold by the CWB are not available from other exporting countries. The CWB must also exercise its discretion in determining the price spreads that most appropriately reflect the relative value contributed by each grade to the pool accounts during the crop year. This is done based on customer knowledge, sales experience, and an assessment of the current market conditions and price expectations.

How does the CWB calculate the total net pooled returns to farmers?

The total net pooled returns to farmers are based on the final weighted average price spreads. These are calculated by multiplying the monthly price spreads times the total amount of grain sold by the CWB during each month of the crop year.

The weighting of the price spreads by the total amount of grain sold for each month, as opposed to the total amount of grain sold by grade for each month, ensures that the "inter-grade" price relationships within a pool account are maintained regardless of when a specific grade was sold by the CWB during the crop year.